Industry Developments and Alerts

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American Institute of Certified Public Accountants. Auditing Standards Division

COMPILATION AND REVIEW ALERT

AICPA

American Institute of Certified Public Accountants

Compilation and Review Alert—1997/98

Update on Practice Developments and Professional Standards

Issued by the Professional Standards and Services Group

Notice to Readers

This Compilation and Review Alert is intended to provide CPAs with an overview of recent practice developments and professional standards that may affect the compilations and reviews they perform. This document has been prepared by the AICPA staff. It has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA.

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In This Year's Alert...

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Compilation and Review Alert — 1997/98

Introduction

The *Compilation and Review Alert—1997/98* is a nonauthoritative practice aid designed to help accountants plan and perform their 1997 and 1998 compilation and review engagements. It clarifies certain existing professional standards, suggests ways of implementing Statements on Standards for Accounting and Review Services (SSARSs) in special circumstances, points out pitfalls that frequently occur in compilation and review engagements, and summarizes new professional pronouncements.

Status of the Assembly Exposure Draft and the Applicability of SSARS No. 1

What are the latest developments regarding the assembly services issue and the applicability of SSARS No. 1?

In September 1995, the Accounting and Review Services Committee (ARSC) issued an exposure draft of a proposed SSARS entitled *Assembly of Financial Statements for Internal-Use Only.* The proposed SSARS would permit CPAs to submit financial statements to their clients without having to comply with the requirements of SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100), if distribution of the financial statements were restricted to internal personnel. Proponents of the proposal believe that many non-public entities do not need financial statements that comply in all material respects with generally accepted accounting principles (GAAP) or an Other Comprehensive Basis of Accounting (OCBOA) if the statements are for internal use only. They believe that the requirement to report on financial statements and to identify departures from the basis of accounting used adds unnecessary time and cost to engagements. Opponents of the proposal believe that the proposed SSARS would increase the incidence of material misstatements in financial statements resulting from these engagements because the proposal does not establish a minimum level of adherence to GAAP or an OCBOA. They agree that many nonpublic entities may not need financial statements that comply in all material respects with GAAP or an OCBOA. However, CPAs cannot control the distribution of financial statements they submit to their clients, and it is believed that many of these statements may be passed on to banks and other creditors without a compilation report to inform readers of the limitations of the work performed on the statements and the deficiencies in them. In addition, opponents of the proposal believe that the exemption is not needed because existing standards provide CPAs with various options for performing less complex and less time-consuming compilations.

The AICPA received more than 500 comment letters on this highly controversial proposal, and when the ARSC met in February 1996 to discuss the comment letters, committee members concluded that they needed additional information about the kinds of problems CPAs encounter when performing compilation engagements. To obtain this information, the ARSC sent a questionnaire to all the commenters who had written letters in support of the exposure draft, called some of those commenters, and invited members of the AICPA Small Firm Advocacy Committee to the May 1996 meeting to talk about the problems practitioners are experiencing.

Public Hearing

After extensive discussion, the ARSC decided that the best way to obtain ideas about clarifying the applicability of SSARS No. 1 was to conduct a public hearing. Thus, on August 27 and 28, 1997, the ARSC conducted a public hearing to hear views on the following questions related to the applicability of SSARSs.

- ***The Submission Issue.*** Can the applicability section of SSARS No. 1 be clarified to enable CPAs to determine easily when they are and are not required to compile financial statements? Paragraph 7 of SSARS No. 1 requires CPAs to, at a minimum, compile financial statements they "submit" to a client or others. Some CPAs would like the definition of submission to be clarified, especially in the context of financial statements in an electronic format.

- *Exemption From SSARS.* Should the applicability section of SSARS No. 1 be revised to exempt CPAs from the requirement to compile financial statements in certain situations? For example, existing standards impose no requirement on a CPA to report on financial information contained in a tax return, or on personal financial statements included in a written personal financial plan.
- *Plain-Paper Financial Statements.* Should CPAs be permitted to issue plain-paper financial statements? Plain-paper financial statements are statements that a CPA does not report on that may be circulated to clients and others. The statements do not disclose the identity of the CPA who has prepared them or the fact that they have been prepared by a CPA. Some CPAs would like the applicability section of SSARS No. 1 to be revised so a CPA would be required to compile financial statements only if he or she were engaged to do so.

Nineteen speakers participated in the public hearing. Nine of those speakers were present at the hearing and ten participated by telephone. Five letters from commenters were received before the hearing and were presented to the ARSC by the AICPA staff. The ARSC also received five comment letters after the hearing.

There were divergent views as to (*1*) whether SSARSs should be clarified to enable CPAs to determine easily when they are required to compile financial statements, and (*2*) whether the applicability section of SSARS No. 1 should be revised to exempt CPAs from the requirement to compile financial statements in certain situations.

Table 1 summarizes the views expressed on the proposal to permit CPAs to issue plain-paper financial statements.

TABLE 1

Source of Comment	*In Support of Plain-Paper*	*Opposed to Plain-Paper*	*Total*
Participants in the hearing	2	17	19
Letters received before the hearing	1	4	5
Letters received after the hearing	1	4	5
Total	4	25	29

On October 13, 1997, the ARSC met to discuss the views expressed at the public hearing and to determine what follow-up action was required. At that meeting, the ARSC voted to withdraw the proposed SSARS because —

- It is predicated on restricted distribution of financial statements, and CPAs cannot control the distribution of financial statements by their clients.
- No objective performance standards apply to assembly engagements.

The ARSC also concluded that CPAs should not be permitted to issue plain-paper financial statements. Although the ARSC has withdrawn the proposed SSARS and concluded that plain-paper financial statements should not be permitted, it believes that the proposal brought important issues to light, which the ARSC plans to address through other approaches, such as clarification of the applicability of SSARS or specific exemptions from SSARS.

Controllership Issues — What Is Going on in Practice?

Have there been any developments regarding the applicability of SSARSs to controllership services?

Many CPAs provide part-time or full-time controllership services to their clients. They maintain the accounting books and records, prepare financial statements, and perform significant management functions for their clients, such as hiring employees, authorizing purchases, investing idle cash, and signing checks. A number of these CPAs contend that the services they perform are the same as those performed by management and that they are really functioning as management. They believe that SSARSs should not be applicable to the financial statements they prepare because a compilation report is used by an outside accountant to report on financial statements that are the representations of another party. Because they are functioning as management, the representations in the financial statements are their own representations, rather than those of another party.

Existing standards do not address this situation, with the exception of Technical Practice Aid (TPA) No. 9, "Reporting on Financial Statements Submitted by Management" (AICPA, *Technical Practice Aids,* sec. 9600.22) which provides guidance to CFOs who ask whether they may use the standard compilation report when reporting on financial statements that they submit to their employer. The TPA states, "The compilation report is inappropriate. A compilation report is used by an outside accountant to report upon financial statements that are the representation of another party, namely, management of a nonpublic company.... The CFO, on the other hand, is a part of management and is intimately involved in the preparation of the financial statements."

At its March 1997 meeting, the ARSC discussed this topic and voted to expose for comment a proposed amendment of SSARS No. 1 that would preclude a CPA from compiling financial statements for a client if the CPA performed services that are equivalent to those preformed by management. In current practice, ways the standards are interpreted are diverse. Some CPAs who provide controllership services to their clients compile the financial statements they prepare, noting a lack of independence in the compilation report. Other CPAs believe that they are exempt from the compilation standards in these circumstances. In response to this gap in the literature, the ARSC has drafted a proposed amendment of SSARS No. 1 that would codify the ARSC's thinking on this issue. Following is a draft of that amendment, which the ARSC plans to expose for comment before issuance:

> This Statement recognizes that accountants may perform services for clients that are equivalent to those ordinarily performed by management. Such services entail making management decisions for clients or having the authority to do so. If an accountant performs services for a client that entail making management decisions for a client or having the authority to do so, the accountant would be deemed to be acting as a member of the client's management and would be precluded from compiling that client's financial statements covering the period during which the accountant performed these services or had the authority to do so.
>
> Examples of services an accountant might perform, or have the authority to perform, that entail making management decisions for a client are the following:
>
> - Hiring and terminating employees
> - Authorizing purchases or expenses
> - Signing checks
> - Making investment decisions
> - Having custody of assets
> - Making credit or banking decisions
> - Signing contracts
> - Serving as an officer or director of an entity
> - Serving in a fiduciary capacity, for example, serving as a trustee or executor

Applicability of SSARS to Different Engagements

How do SSARSs apply to many of the new types of engagements encountered in current practice?

Many CPAs are uncertain about whether the services they perform for their clients constitute a submission of financial statements. The term *submission of financial statements* is pivotal in

SSARS No. 1, because if an accountant submits financial statements to a client or others, he or she is required to at least compile the financial statements. If a CPA has not submitted financial statements, the SSARS is not applicable to the engagement. SSARS No. 1 defines the submission of financial statements as presenting financial statements to a client or others that the accountant has —

- Generated, either manually or through the use of computer software.
- Modified by materially changing account classification, amounts, or disclosures directly on client prepared financial statements.

In most situations, the applicability of the SSARS is fairly clear; however, the applicability may become blurry in certain situations, especially those involving computer-generated financial statements. Table 2 contains scenarios described and conclusions reached by members of the ARSC based on existing standards.

TABLE 2

Situation	*Is SSARS No. 1 Applicable?*	*Reference*
The CPA prepares financial statements for a client and attaches them to a tax return. The financial statement information correlates with the information requested on the tax return. The CPA gives the returns and the statements to the client, who submits them to the taxing authority.	No	Interpretation No. 10 of SSARS No. 1, *Reporting on Tax Returns*
The CPA performs the services described in the preceding situation. The client informs the CPA	No	Interpretation No. 10 of SSARS No. 1

(continued)

Situation	*Is SSARS No. 1 Applicable?*	*Reference*
that he or she intends to submit the tax return packet to parties other than the taxing authority		
The CPA attaches interim financial statements to an annual tax return. Because the financial statements are for a period other than that covered by the tax return, they will not be submitted to the taxing authority.	Yes	Interpretation No. 10 of SSARS No. 1 assumes the information attached to a tax return correlates with the information requested in the tax return.
A client gives client prepared financial statements to a CPA. The CPA posts adjustments to the client's financial statements in a worksheet format (either manually or using a computer) to reflect the tax closing, and carries the adjusted balances forward. The CPA gives the client the financial statement worksheet so the client can enter the adjustments into his or her client's accounting system to reflect the tax closing.	Yes	Paragraphs 7a and 7b of SSARS No. 1
On a separate sheet of paper, the CPA prepares adjustments to client-prepared financial statements and gives the adjustments to the client. The client posts the adjustments to the financial statements and sends the adjusted financial statements to	No	Paragraph 7 of SSARS No. 1

Situation	*Is SSARS No. 1 Applicable?*	*Reference*
the CPA for his or her consideration.		
The CPA enters adjustments to the client's financial statement database using the client's computer, prints the adjusted financial statements, and takes the financial statements with him or her. The CPA does not give the statements to the client. The client has the ability to access the adjusted financial statements by viewing them on the computer monitor or printing them.	Yes	By causing the computer to create adjusted financial statements, the accountant has generated financial statements.
The CPA is engaged to compile the client's financial statements. The CPA prepares the financial statements and shows them to the client for his or her review. The client or CPA notes a problem in the statements, and the CPA adjusts the statements and shows a revised draft of the statements to the client. Several additional versions of the financial statements are prepared for the client's review.	No, for the drafts; yes for the final financial statements	Interpretation No. 17 of SSARS No. 1, *Submitting Draft Financial Statements*
The CPA meets with the client's bookkeeper to discuss client-prepared financial statements. The CPA notes a problem in	No	Paragraph 7 of SSARS No. 1

(continued)

Situation	*Is SSARS No. 1 Applicable?*	*Reference*
the statements and communicates the required adjusting entries to the bookkeeper, either orally or in writing, but not directly on the client-prepared financial statements. The bookkeeper enters the adjusting entries into the computer, prints the revised financial statements, and shows them to the CPA. The CPA reads the financial statements and informs the bookkeeper that no further adjustments are required. The bookkeeper gives the CPA and the client a copy of the financial statements, which the CPA discusses with the client.		
The client sends the CPA a computer disk that contains client-prepared financial statements. The CPA adjusts the financial statements on the disk, which results in revised financial statements. The CPA returns the disk to the client.	Yes	Paragraph 7 of SSARS No. 1

Distribution of Draft Financial Statements

What are a practitioner's responsibilities when a client indicates that he or she plans to submit draft financial statements to others?

A client may indicate to a CPA that he or she plans to submit draft financial statements that the CPA has prepared to a bank or other third party, before to the completion of the compilation or review engagement. The CPA may have completed a substantial portion of the work on the financial, but may be missing certain information or may not yet have performed all the required procedures. The authors of this Alert believe that a CPA should not submit draft financial statements to a bank or other third party before to the completion of a compilation or review engagement. However, Interpretation No. 17 of SSARS No. 1, "Submitting Draft Financial Statement" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.61–.62) indicates that a CPA may submit draft financial statements to a client when (*1*) information needed to complete a compilation or review of the financial statements will not be available until a later date or (*2*) to provide a client with the opportunity to read and analyze the financial statements before to their final issuance. The CPA may do this as long as the CPA marks the statements with words, such as "Draft-subject to change," and intends to submit final financial statements with an appropriate compilation report when the information needed to complete the compilation becomes available.

If a client indicates that he or she plans to submit draft financial statements to a bank or other third party before the completion of the compilation or review, the CPA should inform the client that the best course of action is to wait until the compilation or review of the financial statements is completed and the work is finalized. Doing so will provide the financial statement user with better information. However, a CPA is not responsible for and cannot control the distribution of draft financial statements that he or she has submitted to a client.

In the Legal Scene column of the *Journal of Accountancy*, Wayne Baliga describes a case involving draft financial statements in an audit engagement.[1] Baliga notes that such actions as haphazardly distributing draft financial statements can come back to haunt a firm in a malpractice action and that prudent risk management at a firm can prevent or reduce the magnitude of a claim. In the case cited, two factors prevented a much larger verdict against the

1. Wayne Baliga, "Court Rules on Contributory Negligence," *Journal of Accountancy.* V. 184, No. 4 (October 1997): Page 24.

CPA firm: conspicuous labeling of every page of the draft financial statements with the words "Preliminary draft, for discussion purposes only" and its limited distribution of the report to selected members of the client's staff.

Consideration of Fraud and Internal Control in a Compilation or Review Engagement

What are a practitioner's responsibilities for the consideration of fraud and internal control in compilation and review engagements?

An accountant is not required to document his or her assessment of fraud or gain an understanding of internal control; however, in a compilation or review engagement, the client or other users of the financial statements may have some expectations that the accountant has responsibilities for fraud or internal control that go beyond the requirements of SSARS No. 1. Moreover, with the issuance of AICPA Statement on Auditing Standards (SAS) No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), and SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit*: An Amendment to Statement on Auditing Standards No. 55, (AICPA, *Professional Standards*, vol. 1, AU sec. 319), many practitioners are unsure of their responsibilities for the consideration of fraud and internal control in a compilation or review engagement.

An accountant is not required to plan and perform a compilation or review engagement to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud nor is an accountant required to gain an understanding of an entity's internal control when conducting a compilation or review engagement. This does not, however, relieve the accountant of responsibility if incorrect, incomplete, or otherwise unsatisfactory information comes to the accountant's attention during the engagement.

SSARS No. 1 requires the accountant to obtain additional or revised information if the accountant becomes aware while conducting a compilation that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. The accountant should perform the additional procedures he or she deems necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with GAAP. Also if the entity refuses to provide additional or revised information, the accountant should withdraw from the compilation engagement.

Although management is responsible for the prevention and detection of fraud and the maintenance of internal control, many small business clients view their CPAs as part of their management team. These clients may have unrealistic expectations and may assume that the CPA is doing more than he or she was engaged to do, including detecting fraud and internal control weaknesses. If fraud is discovered, the client may blame the CPA for failing to communicate internal control weaknesses and, in the worst case, may sue the CPA.

Paragraph 8 of SSARS No. 1 states:[2]

> The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report the accountant expects to render. The understanding should also provide (*a*) that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts and (*b*) that the accountant will inform the appropriate level of management of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential.

Although a written engagement letter is not required in a compilation or review engagement, the CPA may find such a letter helpful to clarify and document the understanding between the CPA and the client about the CPA's responsibility regarding fraud and internal control weaknesses. The language illustrated in appendix C of SSARS No. 1, as amended by SAS Nos. 78 and 82, for an engagement letter for a review engagement is as follows:

2. See the appendix of this Alert for conforming changes made to SSARS No. 1 as a result of the issuance of SAS Nos. 78 and 82.

> A review does not contemplate obtaining an understanding of internal control or assessing control risk, testing the accounting records, obtaining corroborating evidential matter, or certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that we will become aware of all significant matters that would be disclosed in an audit. Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any fraud or illegal acts that come to our attention, unless they are clearly inconsequential.

Similarly, the language illustrated in appendix B of SSARS No. 1 as amended by SAS Nos. 78 and 82 for an engagement letter for a review engagement is as follows:

> Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any fraud or illegal acts that come to our attention, unless they are clearly inconsequential.

Language can be added to a compilation engagement letter to indicate that a compilation does not require the CPA to obtain an understanding of the entity's internal control or identify internal control weaknesses.

A second way to minimize misunderstandings is to make clear to the client his or her responsibility to prevent and detect fraud. An effective way to do this is to educate the client as to the importance of internal control in the prevention of fraud. The CPA is then in the position to work with the client in a separate consulting engagement, to improve the client's internal control. This exercise results in several benefits for both the CPA and the client. One advantage is the client's increased awareness of the importance of internal control will aid in the design of suitable controls. Controls will result in the reduction of the risk of fraud and other errors. In addition, this exercise clarifies management's responsibility to prevent and detect fraud thereby reducing the CPA's legal risk. Finally, the CPA has the opportunity to increase revenues by offering consulting services to the client, gaining knowledge of the client's business and becoming more valuable to the client.

Analytical Procedures in a Review Engagement

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. Analytical procedures are evaluations of financial information made by a study of plausible relationships among both financial and nonfinancial data. A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to exist and continue in the absence of new conditions. Frequently, analytical procedures may identify potential material misstatements. The results of analytical procedures should be used as a basis for making additional inquiries and obtaining additional information. The proper use of analytical procedures goes beyond just calculating ratios and trends. It entails calculating and analyzing ratios and trends, identifying significant fluctuations, and investigating their cause.

SSARS No. 1 states that analytical procedures consist of—

1. Comparing financial statements with statements of comparable prior period(s).

2. Comparing financial statements with anticipated results, if available (for example, budgets and forecasts).

3. Studying relationships of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience.

Three basic types of analytical procedures are—

1. Trend analysis — Studying the change in accounts over time

2. Reasonableness tests — Estimating a financial statement amount or the change in an amount from the prior year

and comparing that amount to the existing financial statement amount

3. Ratio analysis — Studying the relationship between two financial statement amounts

When analytical procedures identify significant fluctuations and lead the accountant to believe that information may be incorrect, incomplete, or otherwise unsatisfactory, paragraph 30 of SSARS No. 1, requires the accountant to perform the additional procedures he or she deems necessary to achieve limited assurance that no material modifications should be made to the financial statements.

Management Representation Letters in Review Engagements

What conditions do practitioners need to consider as they obtain management representation letters from their clients?

As part of a review of financial statements, SSARS No. 1 requires an accountant to obtain a written representation from his or her client confirming the oral representations made to the accountant. A management representation letter is not required in a compilation engagement. Written representations from management ordinarily confirm representations made to the accountant, and reduce the possibility of misunderstanding.

Written representations from management should be (*1*) obtained for all financial statements and periods covered by the accountant's review report and (*2*) signed by the current management, owner, or manager. An illustrative representation letter for a review engagement is found in appendix D of SSARS No. 1. The accountant may decide, based on the circumstances of the review engagement, that additional matters should be included in the letter and that some of the representations included in the illustrative letter are not necessary. In other words, representation letters ordinarily should be tailored to include representations that are unique to the entity's business or industry. Certain AICPA Audit and Accounting Guides contain illustrative representation letters that include matters that are unique to a particular industry; therefore, for industries covered by AICPA Audit and Accounting Guides, the accountant may want to consider representations contained in the guides.

In addition, management generally will include additional representations (not unique to a particular industry) that are appropriate when certain conditions exist. Table 3 contains examples of such representations.

TABLE 3

Condition	*Illustrative Representation*
Significant estimates and material concentrations exist that which require disclosure pursuant to Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties.*	We have no knowledge of concentrations existing at the date of the financial statements that make the entity vulnerable to the risk of a near-term severe impact, that have not been properly disclosed in the financial statements. We understand that concentrations include individual or group concentrations of customers, suppliers, lenders, products, services, sources of labor or materials, licenses or other rights, or operating areas or markets. We further understand that severe impact means a significant financially disruptive effect on the normal functioning of the entity.
Financial circumstances are strained, requiring disclosure of management's intentions and the entity's ability to continue as a going concern pursuant paragraphs 10 and 11 of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec. 341).	The financial statements disclose all the facts (that is, significant conditions and events, and our plans) of which we are aware that are relevant to the entity's ability to continue as a going concern.
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired, and the recovery of their carrying costs is uncertain pursuant to	We have reviewed long-lived assets (and certain identifiable intangibles to be held and used) for impairment whenever events or changes in circumstances have indicated that the

(continued)

Condition	*Illustrative Representation*
the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of* (FASB, *Current Text*, vol. 1, sec. I08).	carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
Management intends to, and has the ability to, hold to maturity debt securities classified as held-to-maturity pursuant to FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FASB, *Current Text*, vol. 1, sec.I80).	Debt securities that have been classified as held-to-maturity have been so classified due to our intent to hold such securities to maturity and our ability to do so. All other debt securities have been classified as available-for-sale.
There is a temporary decline in the value of debt or equity securities pursuant to FASB Statement No. 115.	We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.
Receivables have been recorded in the financial statements pursuant to Accounting Research Bulletin (ARB) No. 43.	Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
Excess or obsolete inventories exist pursuant to ARB No. 43.	We have reduced excess or obsolete inventories to their estimated net realizable value.
Material expenditures have been deferred.	We believe that all material expenditures that have been deferred to future periods will be recoverable.
Agreements may exist to repurchase assets previously sold.	All agreements to repurchase assets previously sold have been properly disclosed.
There may be a loss from sales commitments.	We have made provisions for losses to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.

In tailoring representation letters, the accountant should avoid the use of technical terms and use terms that are understandable to the client.

Many clients, due to their limited knowledge of accounting principles, are uncomfortable making the representation that the financial statements present the financial position, results of operations and cash flows of the entity in conformity with GAAP. A modification of the language in the illustrative representation letter in appendix D of SSARS No. 1 may make these clients feel more comfortable about signing the representation letter. The modification might be as follows:

> 1. The financial statements referred to above present the financial position, results of operations, and cash flows of [*name of client*] in conformity with generally accepted accounting principles. However, because of our limited expertise with generally accepted accounting principles, including financial statement disclosure, we have engaged you to advise us in fulfilling that responsibility. In connection with the review of the aforementioned financial statements, we specifically confirm that . . .

It is good practice for the accountant to review the representation letter with the client before the letter is signed. This helps to ensure that management understands the representations they are making and may serve as a "memory jogger" for the client concerning additional important matters that may affect the financial statements. Discussions with the client may also make them feel more comfortable about signing the representation letter by familiarizing the client with the purpose and contents of the representation letter. This discussion may be facilitated by obtaining a copy of the AICPA brochure, *The Representation Letter in a SSARS Review Engagement*, which is designed to explain representation letters to clients.[3]

If the accountant requests a representation letter and the client refuses to provide one, the accountant would not normally be in a position to issue a review report. In addition, a step-down to a compilation is generally not appropriate. SSARS No. 1, paragraph

3. Copies of the pamphlet may be ordered from the AICPA Order Department (Product No. 055120HU).

47, states, "If in an audit or a review engagement a client does not provide the accountant with a signed representation letter, the accountant would be precluded from issuing a review report on the financial statements and would ordinarily be precluded from issuing a compilation report on the financial statements."

The Year 2000 Issue

How might the year 2000 issues affect compilation and review clients?

On January 1, 2000, at 12:00:01 A.M., some computer systems may begin to deliver wrong answers on date calculations. In fact, applications that use future dates may fail before January 1, 2000. The reason is date calculations for many computer programs use two digits instead of four to represent years, such as "97" instead of "1997," to conserve what once was very expensive computer memory. In these programs, the year 2000 will be represented as "00." Some computer systems may recognize "00" as 1900 and not 2000.

Without corrective action, significant problems may occur in the financial functions within an entity. For example, customer balances that are thirty days past due could be incorrectly aged as 100 years and one month past due. There could be invoice printing problems, misleading statements, checks that need manual adjustments, cash flow interruption, and financial statements and subsidiary statements that are improperly dated. Such information as credit card expirations, maintenance-timing schedules, product creation dates, and subscription renewals may be affected. Even if an entity's computers are year-2000-compliant, noncompliant customers, vendors, or third-party data-processing services can affect it. The implications of this computer challenge are already being felt. One major credit card company had to recall its cards when expiration dates in the year 2000 and beyond were rejected by retailers' systems. Solutions to all these problems may come only at great cost. The Gartner Group, an international information technology advisory and market research firm, has estimated the global costs to make software year-2000-compliant to be between $300 billion and $600 billion through 1999.

The FASB's Emerging Issues Task Force (EITF) came to a consensus in Issue No. 96-14, *Accounting for the Costs Associated with Modifying Computer Software for the Year 2000:* "External and internal costs specifically associated with modifying internal-use software for the year 2000 should be charged to expense as incurred." The EITF specifically did not address purchases of hardware or software to replace non-year-2000-compliant software or impairment or amortization issues relating to existing assets. No further EITF discussion is planned.

The AICPA has issued nonauthoritative guidance for practitioners relating to the year 2000 issue, available free of charge on the AICPA's Web site (http://www.aicpa.org) and will be available in print at the beginning of December. The document provides an overview of the year 2000 issue, summarizes the applicable accounting and disclosure guidance and practices currently in effect, and suggests ways that CPAs can help their clients understand the importance of addressing the year 2000 issue.

Practitioners may wish to obtain an understanding of their clients' expectations and raise clients' consciousness and concern about this issue. In addition, the accountant may point out that a compilation or review engagement is not designed to detect whether an entity's information systems are year-2000-compliant. An appropriate place to document this understanding is in the engagement letter. Possible wording may be as follows:

> A compilation (review) of financial statements conducted in accordance with SSARSs is not designed to detect whether an entity's information systems are year-2000-compliant. However, we may choose to communicate matters that come to our attention relating the year 2000 issue for the benefit of management.

In addition, some practitioners are encouraging private entities to disclose the year 2000 issue in notes to compiled or reviewed financial statements. Such notes describe the issue and indicate the current status of corrective action.

Advising the client and planning ahead may help practitioners serve their clients better, deter any potential disputes with the client, as well as create an avenue of new business opportunity for the accountant. Accountants with systems expertise may be in a position to help their clients identify problems. They might discuss the matter with management and may be able to provide consulting services. Because systems projects can span several years from the planning stage to the implementation stage, now is the time to discuss this problem with clients and consider the need for note disclosure in the financial statements.

Additional information relating to the year 2000 issue is available on the Internet at the following Web sites:

Year 2000 Home Page	http://www.year2000.com
Year 2000 Technical Audit Center Page of Audit Serve	http://www.auditserve.com
Audit Net Year 2000 Resources for Auditors	http://users.aol.com/auditnet/Year2000audit.htm

Reporting on an Element of a Financial Statement

A nonpublic entity may wish to engage an accountant to issue a compilation or review report on a separate presentation of specified elements, accounts, or items of a financial statement. Examples of specified elements, accounts, or items of a financial statement may include schedules of rentals, royalties, profit participation, or accounts receivable. SSARS No. 1 provides guidance concerning the standards and procedures applicable to compilations and reviews of financial statements. Presentations of specified elements, accounts, or items of a financial statement do not meet the definition of financial statements; therefore, SSARS No. 1 does not govern this type of engagement. Which standards apply?

SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623), provides guidance for reporting on such presentations if the engagement is intended to result in the expression of an audit opinion. SAS No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622), provides guidance for reporting on the results of applying agreed-upon procedures to specified elements, accounts, or items of a financial statement. SSAE No. 1 provides guidance on reporting on such presentations if the accountant is engaged to express moderate assurance in a review report.

If the accountant is asked to compile, and therefore provide, no assurance on a presentation of a specified element, account, or item of a financial statement, the accountant should comply with Rule 201: General Standards (AICPA, *Professional Standards*, vol. 2, ET sec. 201). Rule 201 does not require the accountant to report on the presentation; however, there is nothing to preclude the accountant from issuing a compilation report on a specified element, account, or item of a financial statement. If the accountant chooses to issue such a report, it may follow the form of a compilation report as suggested in SSARS No. 1; however, the accountant should omit the reference to the SSARS. Such a report might be worded as follows:

> I (we) have compiled the accompanying (*name of presentation*) as of (*date*).
>
> A compilation is limited to presenting information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying (*name of presentation*) and accordingly do not express an opinion or any other form of assurance on it.

Representation Letters for the Compilation of Personal Financial Statements

Why might a practitioner want to obtain a representation letter from a client when compiling personal financial statements?

The term *personal financial statements* refers to financial statements that present the personal assets and liabilities of an individual or a family. The term does not include financial statements presenting the financial position or results of operations of unincorporated businesses, such as proprietorships or partnerships.

CPAs are frequently asked to compile or review personal financial statements for use in obtaining credit, income tax planning, estate or retirement planning, or for public disclosure by candidates for public office. Such statements are clearly within the scope of SSARS No. 1, if the statements are being compiled or reviewed.

SOP 82-1, *Accounting and Financial Reporting for Personal Financial Statements*, is the principal accounting pronouncement that addresses the preparation of personal financial statements. The SOP establishes the current value basis of accounting as GAAP for personal financial statements. The AICPA Personal Financial Statements Guide (PFS Guide) contains guidance on the scope of work and form of report for audits, reviews, and compilations of personal financial statements in accordance with SOP 82-1, and also contains a copy of SOP 82-1.

Paragraph 2.03 of the PFS Guide indicates that, ordinarily, an accountant can compile personal financial statements based on a client's representations about the estimated current values and the amounts of assets and liabilities. However, when compiling personal financial statements, the accountant should at least obtain an understanding of the methods by which the client determined the values and amounts of significant assets and liabilities. The accountant should also consider whether the methods are appropriate in the light of the nature of each asset or liability.

As discussed in the section of this Alert titled Management Representation Letters in Review Engagements, during an engagement, a client will make many representations to the accountant. Paragraph 28 of SSARS No. 1 requires only that representation letters be obtained from a client in a review engagement: however, because of the informal nature of most personal financial records, some practitioners obtain written representations from the client to confirm the oral representations made in personal financial statement compilation engagements. A sample of a client representation letter for a compilation or review engagement can be found in appendix C of the PFS Guide.

AICPA Technical Practice Aids

The staff of the AICPA Technical Information Service responds to questions from practitioners on a daily basis. Commonly asked questions become a source of Technical Practice Aids (TPAs) that are included in the AICPA publication *Technical Practice Aids.*[4] Thus, many questions asked by practitioners are often answered in the TPAs. *Technical Practice Aids* contains unofficial views expressed by the AICPA Technical Information Service, and comments of the Technical Information Service staff should be accepted as the personal views of the individuals who offer them. Practitioners should consult the AICPA Technical Practice Aids (AICPA, *Technical Practice Aids*, sec. 9600) for the following TPAs that are specifically related to compilation and review services.

TPA No. 1, *"Compiled Financial Statements Not Adjusted."* For interim financial statements that do not include material adjustments for changes in inventories, prepayments, and accruals, the accountant's report should disclose the specific departures from GAAP in a separate paragraph(s).

TPA No. 2, *"Inquiries for a Review Engagement."* In a review engagement, the accountant's professional judgment is paramount in selecting appropriate inquiry and analytical procedures. Sufficient inquiries and analytics must be performed to achieve limited assurance. Moreover, a review is not a mechanical exercise to obtain "yes" or "no" answers to a laundry list of inquiries.

TPA No. 4, *"Financial Statements Marked as Unaudited."* SSARS No. 1 requires that each page of the financial statements include a reference, such as "See Accountant's Compilation Report" or "See Accountant's Review Report," as appropriate. This TPA discourages the use of the reference "unaudited" on each page of the financial statements. The term *unaudited* in a private entity setting is somewhat ambiguous; the term covers both reviews and compilations.

TPA No. 8, *"Supplementary Information."* If supporting schedules of balance sheet or income statement accounts are not identified as being part of the basic financial statements, they are considered

4. *Technical Practice Aids* is available in both a loose-leaf subscription format and an annual paperback edition format (order number G10103SM for a one-year subscription in a loose-leaf format; or order number 005056SM for the annual paperback edition).

supplemental information and should be reported on in accordance with paragraph 43 of SSARS No. 1.

TPA No. 9, *"Application of SSARS 3 to Certain Companies Required to File with Regulatory Bodies."* An accountant may use the alternative form of compilation report presented in SSARS No. 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300) if the entity (a privately owned broker or dealer in securities) is not submitting financial statements in a prescribed form in connection with the actual or contemplated sale or trading of its own securities.

TPA No. 10, *"Review of Financial Statements Included in a Prescribed Form."* An accountant may perform a review of the financial statements included in a prescribed form prepared under a tax or cash basis of accounting, provided that SSARS No. 1 (not SSARS No. 3) is followed (see *Professional Standards,* vol. 1, AR sec. 100.40).

TPA No. 11, *"Computer Generated Financial Statements."* If a client directly inputs data via modem from his or her office into the CPA's computer and generates financial statements in the client's office, the CPA should not report on those financial statements.

TPA No. 12, *"Use of Other Comprehensive Basis of Accounting (OCBOA) for Interim Financial Statements and Generally Accepted Accounting Principles (GAAP) for Annual Financial Statements."* A privately held entity may use OCBOA for interim financial statements and GAAP for annual financial statements.

TPA No. 14, *"Uncertainties/Going Concern Problems."* An accountant is not required to modify a compilation or review report if the financial statements appropriately disclose the uncertainty; however, an accountant is not precluded from emphasizing an uncertainty in a separate paragraph of his or her report.

TPA No. 15, *"Consistency."* The accountant is not required to modify a compilation or review report if the financial statements appropriately disclose the consistency matter; however, the accountant is not precluded from emphasizing the consistency matter in a separate paragraph of the report.

TPA No. 16, *"Reference to Accountant's Report in Notes to Financial Statements."* Notes are an integral part of financial statements. Some accountants include a reference to the accountant's report (for example, See Accountant's Review Report) to the accountant's report on each page of the financial statements, including the pages that contain notes to the financial statements. Others believe that if the basic financial statements contain a statement indicating that the notes are an integral part of the statements, it is not necessary to refer to the accountant's report on the note pages.

TPA No. 18, *"Bank Engaged a CPA Firm to Compile a Financial Statement of Another Entity."* Although SSARS No. 1 does not preclude an accountant from compiling the financial statements of one entity when engaged by another entity, this TPA cautions the CPA that to compile the financial statements, the accountant should possess a general understanding of the nature of the entity's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. Furthermore, if the records of an entity are being held by a third party, the accountant may not be able to obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed as required by rule 201 of AICPA Rules of Conduct, paragraph 1D.

TPA No. 19, *"Issuance of an Audit Report on Financial Statements Which Have Already Been Reviewed."* An accountant may accept an engagement to audit financial statements that previously have been compiled or reviewed.

TPA No. 20, *"Reissuance When Not Independent."* If an accountant reviews the prior year's financial statements, while independent, and compiles in the current year's financial statements when independence is impaired, the accountant may reissue the report on the prior year's financial statements without modifying the report. (See also, SSARS No. 2, *Reporting on Comparative Financial Statements* [AICPA, *Professional Standards,* vol. 2, AR sec. 200.12])

TPA No. 21, *"Income Taxes Omitted on Interim Financial Statements."* Conformity with GAAP requires the accrual of income tax liabilities in interim financial statements even though the client intends to use year-end tax savings techniques, such as bonuses. This TPA presents an example of an accountant's compilation report that would be appropriate when the client departs from this GAAP requirement.

TPA No. 22, *"Reporting on Financial Statements Submitted by Management."* It is not appropriate for a corporation's chief financial officer (CFO) to submit a compilation report when issuing the corporation's financial statements, because the standard compilation report is appropriate for reporting on only financial statements that are the representation of another party. This TPA presents an example of a report that might be used by a CFO when issuing the financial statements of the corporation.

TPA No. 24, *"Issuing a Compilation Report With Substantially All Disclosures Omitted After Issuing a Report on Financial Statements Containing Full Disclosure."* An accountant may issue a compilation report on financial statements with substantially all disclosures omitted if he or she previously issued an audit, review, or compilation report on financial statements with full disclosure for the same reporting period.

Statements on Standards for Accounting and Review Services (SSARSs) Interpretations

The AICPA Accounting and Review Services Committee issues Statements on Standards for Accounting and Review Services, the senior technical committee of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Council has designated the AICPA Accounting and Review Services Committee as a body to establish technical standards under rule 202 of AICPA Rules of Conduct.

The staff of the Accounting and Review Services Committee has been authorized to issue Interpretations to provide timely guidance on the application of pronouncements of the Accounting and Review Services Committee. Members of that committee review Interpretations. An Interpretation is not as authoritative as a pronouncement of the Accounting and Review Services Committee, but members should be aware that they may have to justify a departure from an Interpretation if the quality of their work is questioned.

The AICPA Technical Information Service frequently fields questions having fact patterns similar to those addressed in the SSARS Interpretations. Following is a summary of SSARS Interpretations currently in effect.

Interpretations of SSARS 1

Interpretation No. 1, "Omission of Disclosures in Reviewed Financial Statements" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.01–.02), precludes the accountant from accepting an engagement to review financial statements that omit substantially all the disclosures required by GAAP. This Interpretation gives guidance on the reporting implications if an accountant who has undertaken to review financial statements subsequently finds that the client declines to include substantially all required disclosures.

Interpretation No. 2, "Financial Statements Included in SEC Filings" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.03–.05), emphasizes the need for professional judgment in deciding whether an entity is a public or nonpublic entity for purposes of determining the applicability of AR sec. 100.

Interpretation No. 3, "Reporting on the Highest Level of Service" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.06–.12), requires that if an accountant provides more than one level of service on the same financial statements, the financial statements should be accompanied by the accountant's report that is appropriate for the highest level of service provided. This Interpretation does not preclude the accountant from using procedures that go beyond those required for the level of assurance expressed. Nor does this Interpretation require that the accountant "step up" the level of his or her report if the accountant uses procedures that go beyond those required for the level of assurance expressed.

Interpretation No. 4, "Discovery of Information After the Date of the Accountant's Report" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.13–.15), emphasizes the need for professional judgment in determining an appropriate course of action when information becomes available after the date of the accountant's report and that information causes the accountant to believe that the compiled or reviewed financial statements may be incorrect, incomplete, or otherwise unsatisfactory. This Interpretation instructs the accountant to consider the reliability of the information and the existence of persons known to be relying on or likely to rely on the financial statements when making a decision about an appropriate course of action.

Interpretation No. 5, "Planning and Supervision" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.16–.17), clarifies that SAS No. 22, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 31) does not apply to compilation or review engagements. However, this Interpretation suggests that the accountant may wish to consider SAS No. 22 and other references when planning and supervising a compilation or review engagement.

Interpretation No. 6, "Withdrawal From Compilation or Review Engagement" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.18–.22), identifies circumstances in which it is appropriate for an accountant to withdraw from an engagement. Circumstances suggested by this Interpretation include those in which the nature, extent, and probable effect of GAAP departures or departures from an OCBOA might cause the accountant to question whether the departures are a result of the preparer's intention to mislead those who might reasonably be expected to use the financial statements. The accountant would also withdraw from a compilation or review engagement if the financial statements are not revised after the accountant requests that revisions be made, and the client refuses to accept the modified standard report that the accountant believes is appropriate.

Interpretation No. 7, "Reporting When There Are Significant Departures From Generally Accepted Accounting Principles" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.23–.26), indicates that a statement in a compilation or review report that the financial statements are not in conformity with GAAP or an other comprehensive basis of accounting" would be tantamount to expressing an adverse opinion on the financial statements taken as a whole; therefore, an accountant is precluded from making such a statement. Such an opinion can be expressed only in the context of an audit engagement. This interpretation does not preclude the accountant from emphasizing the limitation of the financial statements in a separate paragraph of the report. This separate paragraph is not, however, a substitute for disclosure of the specific GAAP or OCBOA departures or the effects of the departures.

Interpretation No. 8, "Reports on Specified Elements, Accounts, or Items of a Financial Statement" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.27–.28), clarifies that the SSARS 1 reporting requirements for a review do not apply to presentations of specified elements, accounts, or items of financial statements because these presentations do not meet the definition of a financial statement. This Interpretation refers the accountant to SAS No. 75 for guidance on reporting on the results of applying agreed-upon procedures to specified elements, accounts, or items of a financial statement. SSAE provide guidance on reporting on such presentations when the accountant is engaged to express moderate assurance in a review report.

Interpretation No. 9, "Reporting When Management Has Elected to Omit Substantially All Disclosures" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.29–.30), allows the accountant to modify the language in the sample report in paragraph 21 of SSARS 1 from "Management has elected to omit substantially all disclosures." However, this Interpretation stresses that the language used must clearly indicate that the omission of substantially all disclosures is the entity's decision, not the accountant's. The Interpretation encourages the use of the language in the sample report in paragraph 21 of SSARS 1.

Interpretation No. 10, "Reporting on Tax Returns" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.31–.32), exempts the accountant from compiling the financial information contained in a tax return, although the accountant may accept an engagement to compile or review on such a presentation.

Interpretation No. 11, "Reporting on Uncertainties" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.33–.40), directs the accountant to paragraphs 10 and 11 of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, for guidance in evaluating the disclosure of uncertainties. This Interpretation does not require the accountant to modify his or her report if uncertainties are appropriately disclosed in the financial statements; nor does the interpretation require modification of a compilation report on financial statements that omit substantially all disclosures required by GAAP, provided the report clearly indicates the omission and says that the client's decision to omit the disclosures was not, to the accountant's knowledge, undertaken with the intention of misleading users of the statements. The Interpretation suggests, but does not require, language that may be used if an accountant wishes to draw attention to an uncertainty in an emphasis paragraph of a compilation or review report.

Interpretation No. 12, "Reporting on a Comprehensive Basis of Accounting Other than Generally Accepted Accounting Principles" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.41–.45), indicates how the standard compilation and review reports should be modified if financial statements are prepared on another comprehensive basis of accounting.

Interpretation No. 13, "Additional Procedures" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.46–.49), permits the accountant to perform additional procedures in a compilation or review engagement without requiring the accountant to change the engagement level.

Interpretation No. 15, "Differentiating a Financial Statement Presentation from a Trial Balance" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.54–.57), identifies the attributes of a financial statement and those of a trial balance. It assists an accountant in determining whether a financial statement presentation is a financial statement, requiring compliance with the provisions of SSARS 1, or a trial balance which does not require compliance with the provisions of SSARS 1.

Interpretation No. 17, "Submitting Draft Financial Statements" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.61–.62), prohibits an accountant from submitting draft financial statements without intending to submit those financial statements in final form accompanied by an appropriate compilation or review report. This Interpretation requires that draft financial statements be so marked and suggests that an accountant document the reasons why he or she intended to submit, but never submitted final financial statements, should that situation occur.

Interpretation No. 18, "Special-Purpose Financial Presentations to Comply With Contractual Agreements or Regulatory Provisions" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.63–.72), permits an accountant, if asked to report on special-purpose financial statements prepared to comply with a contractual agreement or regulatory provision that specifies a special basis of presentation, to issue a compilation or review report on those financial statements in accordance with SSARS No. 1. The Interpretation describes how to report on presentations based on contractual agreements or regulatory provisions that require a financial presentation that (*1*) does not constitute a complete presentation of the entity's assets, liabilities, revenues, or expenses but is otherwise prepared in conformity with GAAP or OCBOA or (*2*) uses a prescribed basis of accounting that does not result in a presentation in conformity with GAAP or OCBOA.

Interpretation No. 19, "Reporting When Financial Statements Contain a Departure From Promulgated Accounting Principles That Prevents the Financial Statements From Being Misleading"(AICPA, *Professional Standards*, vol. 2, AR sec. 9100.73–.75), addresses Rule 203: Accounting Principles of AICPA Code of Professional Conduct which prohibits a member from expressing an opinion that financial statements are presented in conformity with GAAP if the member is aware that the statements contain a GAAP departure. If the statements contain a GAAP departure, and the member can demonstrate that due to unusual circumstances compliance with GAAP would render the financial statements misleading, the member can comply with rule 203 by describing in the report the departure; its approximate effects, if practicable; and the reasons why compliance with GAAP would result in misleading statements.

The Interpretation indicates that if the circumstances contemplated by rule 203 exist in a review engagement, the accountant's review opinion should be unmodified, but the accountant's review report should be modified to contain a separate paragraph, including the information required by rule 203. The Interpretation clarifies that rule 203 does not apply to compilation engagements. If the circumstances contemplated by rule 203 exist in a compilation engagement, an accountant should follow the guidance in paragraphs 39 through 41 of SSARS for reporting on a compilation engagement with a GAAP departure.

Interpretation No. 20, "Applicability of Statements on Standards for Accounting and Review Services to Litigation Services" (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.76–.79), clarifies the circumstances under which litigation services are excluded from the applicability of SSARS.

Interpretation of SSARS 2

Interpretation No. 1, "Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures" of Interpretations of SSARS 2, Reporting on Comparative Financial Statements (AICPA, *Professional Standards*, vol. 2, AR sec. 9200.01–.04), describes the reporting requirements if financial statements that omit substantially all disclosures are compiled from financial statements that previously did not omit substantially all disclosures. In this situation, the accountant's reference to the previous report in the current compilation report should include a description or quotation of any modifications of the previous report and any paragraphs emphasizing a matter regarding the previous financial statements.

Interpretation of SSARS 3

Interpretation No. 1, "Omission of Disclosures in Financial Statements Included in Certain Prescribed Forms" (AICPA, *Professional Standards*, vol. 2, AR sec. 9300.01–.03), permits an accountant who has reviewed the financial statements of a nonpublic entity to issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for a departure from GAAP.

Interpretation of SSARS 4

Interpretation No. 1, "Reports on the Application of Accounting Principles" Interpretation of SSARS 4, Communications Between Predecessor and Successor Accountants (AICPA, *Professional Standards*, AR sec. 9400.01–.05) refers the accountant to SAS No. 50, *Reports on the Application of Accounting Principles* (AICPA *Professional Standards*, AU sec. 625), for guidance for the public accountant who has been asked to provide written or oral advice on the application of accounting principles to specified transactions.

Interpretation of SSARS 6

Interpretation No. 1, "Submitting a Personal Financial Plan to a Client's Advisers" of SSARS 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (AICPA, *Professional Standards*, vol. 2, AR sec. 9600.01–.032) clarifies that developing a client's personal financial goals and objectives includes implementing the personal financial plan by the client or the client's advisers because implementing the plan may be considered the culmination of the process of developing personal financial goals and objectives. The Interpretation allows the accountant to submit a written personal financial plan, to be used by the client or the client's advisers to implement the personal financial plan, without complying with the requirements of SSARS No. 1, provided the conditions in paragraph 3 of SSARS No. 6 exist.

Cash and Income Tax Basis Financial Statements

How should practitioners assess the adequacy of disclosures in cash and tax basis financial statements?

Because there is very little authoritative guidance that explicitly addresses cash or income tax basis financial statements, practitioners frequently have difficulty determining which recognition, measurement, and disclosure rules apply to such financial statements.

Views vary on which recognition, measurement, and disclosure rules apply to cash, modified cash, and income tax basis financial statements. Some practitioners believe that all accounting standards should be stringently applied to all types of financial statements, regardless of the basis of accounting. Others believe that authoritative accounting standards were developed solely for financial statements prepared in accordance with GAAP; therefore, GAAP standards do not apply to statements prepared on other comprehensive bases of accounting.

Paragraph 10 of SAS No. 62, *Special Reports*, requires that financial statements prepared on a comprehensive basis of accounting other than GAAP include a summary of significant accounting policies that describes the basis of presentation and how that basis differs from GAAP. It also states that when such financial statements contain items that are the same as, or similar to, those in statements prepared in conformity with GAAP, similar informative disclosures are appropriate. To illustrate how to apply that statement, paragraph 10 of SAS No. 62 indicates that the disclosures for depreciation, long-term debt, and owners' equity should be "comparable to" those in financial statements prepared in conformity with GAAP. It also states that the auditor "should also consider" the need for disclosure of matters that are not specifically identified on the face of the statements, such as (*1*) related party transactions, (*2*) restrictions on assets and owners' equity, (*3*) subsequent events, and (*4*) uncertainties.

The Audit Issues Task Force (AITF) auditing Interpretation of SAS No. 82 indicates that the discussion of the basis of presentation may be brief and that only differences from GAAP need be described. Quantifying the differences is not required.

The Interpretation states that if cash, modified cash, or income tax basis financial statements have items for which GAAP would require disclosure, the statements should provide either the disclosure that would be required for those items in a GAAP presentation or information that communicates the substance of that disclosure. That may result in substituting qualitative information for some of the quantitative information required for GAAP presentations. For example, disclosing the reduction of the principal amount of long-term borrowings during each of the next five years may not be necessary if the repayment terms are disclosed, and disclosing estimated percentages of total revenues, rather than amounts, may sufficiently convey the significance of certain related party transactions.

The following example illustrates how the Interpretation might be applied.

River Place, a general partnership of three individuals, owns an office building that is pledged as security for a note payable to National Bank. The note requires fixed monthly principal payments plus monthly interest payments at a rate tied to prime. In addition to covenants about the amount of partner distributions, the note has a covenant requiring annual audited financial statements. River Place also has a note payable to the same bank that is secured by maintenance equipment bought in 19X1.

The bank has always accepted financial statements prepared on the basis of accounting that River Place uses to prepare its federal income tax returns. Here is some relevant information about River Place's operations:

- Entities that are controlled by the three partners lease space in the office building.
- There is a significant, unrelated tenant.
- River Place frequently provides rent-free periods as an incentive to attract and retain tenants.
- Increases in certain operating expenses are passed on to the tenants through rent increases. Those increases are not tied to a specific index or rate.
- As a reserve for improvements, River Place keeps large amounts of cash at National Bank in an interest-bearing account that is not federally insured.

- During 19X1, River Place sold a parcel of land adjacent to its rental property. Proceeds from the sale consisted entirely of cash, which the partnership invested in marketable equity securities. River Place is looking for suitable additional real estate and plans to sell the securities and use the proceeds to fund most, if not all, of the cost of the property.

The major sources of the difference between the financial results for tax reporting and the results for GAAP are —

- Recognizing rent income under leases with rent-free periods when the payment is due rather than recognizing the income over the lease period.
- Use of a shorter depreciation period for tax reporting because the building was placed in service before the effective date of the Tax Reform Act of 1986.
- Reporting marketable equity securities at cost rather than fair value.

The statement of financial position is unclassified, and the land sold in 19X1 was previously reported in a separate line item captioned Investment Land. Some additional relevant financial statement line items are as follow:

- Statements of financial position
  - Marketable equity securities
  - Rental property, less accumulated depreciation of $265,000 in 19X1 and $225,000 in 19X0
  - Notes payable to National Bank
- Statements of results of operations
  - Rental income
  - Interest expense
  - Gain on sale of investment land
  - Net gain from sales of marketable equity securities

Illustrative Notes to Income Tax Basis Financial Statements	*Illustrative Notes to GAAP Financial Statements*
Summary of Significant Accounting Policies The accompanying financial statements present financial results on the basis of accounting that River Place uses for federal income tax reporting. The basis differs from generally accepted accounting principles primarily because (*1*) rental income is recognized when due rather than evenly over the lease terms, (*2*) the periods used to calculate depreciation under the straight-line method are as prescribed by the Internal Revenue Code rather than estimated useful lives, and (*3*) marketable equity securities are reported at cost rather than fair value.	*Summary of Significant Accounting Policies* Rental income is recognized evenly over the lease terms, and depreciation is calculated using the straight-line method.
Nature of Operations River Place is a general partnership and leases office space in a building located in Short Pump, Virginia. The lease with one tenant provides approximately one-third of the rental income and expires in five years. Most of the remaining leases have base periods of three or five years and offer the option of extending the lease for a similar period at market rates. Leases often have rent-free periods to attract and retain tenants, and increases in certain operating expenses are passed to tenants through rent increases. Leases with entities controlled by the partners generate approximately 10 percent of the partnership's rental income.	*Nature of Operations* River Place is a general partnership and leases office space in a building located in Short Pump, Virginia. The lease with one tenant provides approximately one-third of the rental income and expires in five years. Most of the remaining leases have base periods of three or five years and offer the option of extending the lease for a similar period at market rates. Contingent rents to cover increases in certain operating expenses totaled \$25,000 in 19X1 and \$28,000 in 19X0. Rental income from leases with entities controlled by the partners totaled \$85,000 in 19X1 and \$80,000 in 19X0. Future rentals due under leases in force at the end of 19X1 total \$2,300,000 and are due in the amounts of \$700,000 in 19X2, \$650,000 in 19X3, \$550,000 in 19X4, and \$200,000 in both 19X5 and 19X6.

(continued)

Illustrative Notes to Income Tax Basis Financial Statements	*Illustrative Notes to GAAP Financial Statements*
Cash River Place keeps substantial amounts of cash at National Bank under an interest-bearing account that is not federally insured but is secured by government securities.	*Cash* River Place keeps substantial amounts of cash at National Bank under an interest-bearing account that is not federally insured but is secured by government securities. The maximum losses that could have resulted from that concentration of credit risk were $110,000 at the end of 19X1 and $98,000 at the end of 19X0.
Rental Property Not applicable	*Rental Property* The components of rental property are: — *19X1* / *19X0* Land: $175,000 / $175,000 Building: 475,000 / 450,000 Equipment: 45,000 / 25,000 Total: **695,000** / **650,000** Accumulated Depreciation: 265,000 / 225,000 Net: **$430,000** / **$425,000**
Notes Payable to National Bank A note with a balance of $485,000 at the end of 19X1 and $509,000 at the end of 19X0 is payable to National Bank in monthly installments of $2,000 plus interest at an annual rate of prime plus 1 percent through December 19Y2, when the remaining principal balance is due. The note is secured by the rental property, is guaranteed by the partners, and limits the amount of distributions to the partners. The remaining note payable to National Bank has a balance of $15,000 at the end of 19X1, is secured by equipment purchased during the year, and is payable in monthly installments of $750, which includes interest at an annual rate of 9.5 percent.	*Notes Payable to National Bank* A note with a balance of $485,000 at the end of 19X1 and $509,000 at the end of 19X0 is payable to National Bank in monthly installments of $2,000 plus interest at an annual rate of prime plus 1 percent through December 19Y2, when the remaining principal balance is due. The note is secured by the rental property, is guaranteed by the partners, and limits the amount of distributions to the partners. The remaining note payable to National Bank has a balance of $15,000 at the end of 19X1, is secured by equipment purchased during the year, and is payable in monthly installments of $750, which includes interest at an annual rate of 9.5 percent. Principal

Illustrative Notes to Income Tax Basis Financial Statements	*Illustrative Notes to GAAP Financial Statements*
	reduction of the notes totals $28,000 in 19X2, $32,000 in 19X3, $27,000 in 19X4, and $24,000 in both 19X5 and 19X6.
Net Gains From Selling Marketable Equity Securities Not applicable	*Net Gains From Selling Marketable Equity Securities* Proceeds from the sale of marketable equity securities totaled $70,000 in 19X1 and yielded gains of $40,000 and losses of $15,000. The cost of securities sold was determined by specific identification. At the end of 19X1, the marketable equity securities were recorded at their fair value by recognizing a separate equity account for the gross unrealized holding gains of $35,000.
Supplemental Cash Flows Disclosures Not applicable	*Supplemental Cash Flows Disclosure* Interest payments totaled $50,000 in 19X1 and $46,000 in 19X0. In 19X1, non-cash investing and financing activities consisted primarily of financing the purchase of maintenance equipment through a $20,000 National Bank note. There were no such significant activities in 19X0.

Presentation of the Accountant's Report

Often accountants raise questions about requirements for presentation of their reports. For example, is the CPA firm's letterhead required? Is a manual signature required? Frequently these questions are not addressed in the professional standards. Some state boards of accountancy or regulatory agencies at the state or federal level may have requirements relating to these matters, so it is advisable to check with those bodies.

The professional standards do not require the accountant's compilation or review report to be printed on the firm's letterhead.

However, letterhead adds a level of formality to the presentation. If the accountant's report appears on letterhead, a heading to the report is generally not necessary, although one may be used. If the accountant's report does not appear on letterhead, a heading such as Accountant's Report may be beneficial to reduce misunderstanding about the document.

In General, the accountant's report should be addressed to the owner, manager, board of directors, board of stockholders, or each, in a corporate setting. It is also common practice to sign the report with the firm's signature rather than an individual's signature, unless the accountant is a sole practitioner. Some state boards of accountancy require an individual shareholder's signature if the firm is a professional corporation. Also, some regulatory agencies require the individual engagement partner's signature. SSARS No. 1 does not require that the compilation or review report be manually signed. In the absence of other requirements, the report may be manually signed, or the signature may be typed, computer printed, or stamped with a signature facsimile.

GAAP for Compiled and Reviewed Financial Statements

Although there are different reporting and performance standards for compilation, review, and audit engagements, GAAP for compiled and reviewed financial statements are the same as those for audited financial statements. Footnote 3 of SSARS No. 1 states that the GAAP hierarchy presented in SAS No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 411), is also applicable to compilations and reviews of financial statements performed under SSARSs.

An exception to that rule is found in SSARS No. 1, which permits an accountant to compile financial statements that omit substantially all the disclosures required by GAAP. If the accountant compiles such financial statements, he or she issues a special compilation report to alert readers to the fact that the disclosures have been omitted. An accountant is not permitted to review financial statements that omit substantially all the disclosures required by GAAP.

Because several standard-setting bodies establish GAAP, not a single publication contains all the GAAP pronouncements. Each of the following publications contain's certain pronouncements included in the GAAP hierarchy (that is, the must know GAAP).

FASB Original Pronouncements — Accounting Standards

This two-volume set contains the original text of accounting pronouncements. It includes FASB Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board Opinions, AICPA Accounting Research Bulletins, FASB Technical Bulletins, and AICPA Accounting Interpretations. The pronouncements are arranged chronologically and the text includes a topical index (available from the AICPA).

AICPA Technical Practice Aids (Including Statements of Position)

Statements of Position and Practice Bulletins issued by the AcSEC are included in this text. This publication also contains a selection of nonauthoritative audit, review, compilation, and accounting questions answered by the AICPA's Technical Information Service (available from the AICPA).

FASB Emerging Issues Task Force Abstracts

This text contains a summary of the proceedings of the FASB's EITF. Each abstract summarizes the accounting issues involved and the results of the discussion, including any consensus reached on the issue (available from the FASB).

FASB Implementation Guides (Qs and As)

Implementation guides are published by the FASB staff and provide guidance, in the form of questions and answers, on the implementation of FASB Statements. The following implementation guides are available from the FASB.

- *A Guide to the Implementation of Statement 87 on Employers' Accounting for Pensions*
- *A Guide to the Implementation of Statement 88 on Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*
- *A Guide to the Implementation of Statement 91 on Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*
- *A Guide to the Implementation of Statement 96 on Accounting for Income Taxes*[5]
- *A Guide to the Implementation of Statement 106 on Employers' Accounting for Postretirement Benefits Other than Pensions*
- *A Guide to the Implementation of Statement 109 on Accounting for Income Taxes*
- *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities*

Codification of Governmental Accounting and Financial Reporting Standards

Practitioners who compile or review the financial statements of state and local governmental entities should supplement their professional libraries with the *Codification of Governmental Accounting and Financial Reporting Standards.* This text contains current authoritative accounting and financial reporting standards for state and local governmental entities. GASB Statements, Interpretations, and Technical Bulletins are included (available from the GASB).

AICPA Audit and Accounting Guides

Audit and Accounting Guides summarize the practices applicable to specific industries and describe accounting principles and audit procedures unique to these industries. The accounting

5. FASB Statement No. 96, *Accounting for Income Taxes* was superseded by FASB Statement No. 109, *Accounting for Income Taxes* (FASB, *Current Text,* vol. 1, I27)

guidance included in AICPA Audit and Accounting Guides is in the GAAP hierarchy as authoritative GAAP. When an accountant compiles or reviews the financial statements of an entity, SSARS No. 1 requires that the accountant have or acquire a level of knowledge of the accounting principles and practices of the industry in which the entity operates. Although the audit guidance included in the Audit and Accounting Guides may not be relevant to practitioners performing compilation and review engagements, the industry background, accounting guidance, and illustrative financial statements that are provided should help accountants acquire knowledge of a specific industry. The following industry Audit and Accounting Guides are available from the AICPA:

- Agricultural Producers and Cooperatives (012351SM)
- Airlines (013181SM)
- Banks and Savings Institutions (011175SM)
- Brokers and Dealers in Securities (012177SM)
- Casinos (013148SM)
- Certain Nonprofit Organizations[6] (013165SM)
- Colleges and Universities (013323SM)
- Common Interest Realty Associations (CIRAs) (This Audit and Accounting Guide contains a chapter on compilations and reviews of CIRAs.) (012486SM)
- Construction Contractors (012094SM)
- Credit Unions (012044SM)
- Employee Benefit Plans (012335SM)
- Entities With Oil and Gas Producing Activities (012089SM)
- Federal Government Contractors (012436SM)
- Finance Companies (012464SM)
- Health Care Organizations (012429SM)

6. This guide has been superceded by *Not-for-Profit Organizations*; however, it is still applicable in a governmental environment.

- Investment Companies (012360SM)
- Not-for-Profit Organizations (013166SM)
- Property and Liability Insurance Companies (011919SM)
- State and Local Governmental Units (012056SM)
- Stock Life Insurance Companies (012035SM)
- Voluntary Health and Welfare Organizations[7] (012158SM)

The following general Audit and Accounting Guides also may be of interest to CPAs performing compilation and review engagements:

- Personal Financial Statements (011133SM)
- Prospective Financial Information (011140SM)
- Use of Real Estate Appraisal Information (013158SM)

Also available from the AICPA, in an integrated CD-ROM with a powerful search engine and thousands of links, are AICPA *Professional Standards*, AICPA *Technical Practice Aids,* and AICPA *Audit and Accounting Guide.*

To order AICPA products, call: (800) 862-4272 (menu selection #1); write: AICPA Order Department, P.O. Box 2209, Jersey City, NJ 07303-2209; fax: (800) 362-5066. To order FASB products, call (203) 847-0700, ext. 10.

Recent GAAP Pronouncements

FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities* (an amendment of FASB Statement No. 107)

Statement No. 126 (FASB, *Current Text,* vol. 1, sec. F25) amends Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (FASB, *Current Text,* vol. 1, sec. F25), to make the disclosures about fair value of financial instruments prescribed in Statement 107 optional for entities that meet all the following criteria:

7. Ibid.

1. The entity is a nonpublic entity.
2. The entity's total assets are less than $100 million on the date of the financial statements.
3. The entity has not held or issued any derivative financial instruments, as defined in FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments* (FASB, *Current Text*, vol. 1, sec. F25) other than loan commitments, during the reporting period.

This Statement is effective for fiscal years ending after December 15, 1996. Earlier application is permitted: however, previously issued financial statements should not be restated.

FASB Statement No. 129, *Disclosure of Information about Capital Structure*

Statement No. 129 (FASB, *Current Text*, vol. 1, sec. C24) establishes standards for disclosing information about an entity's capital structure. It applies to all entities. Specifically, the Standard requires the entity to explain, in summary form within its financial statements, the pertinent rights and privileges of the various securities outstanding. The Standard lists examples of information that should be disclosed, including dividend and liquidation preferences, participation rights, call prices and dates, conversion or exercise prices or rates and pertinent dates, sinking-fund requirements, unusual voting rights, and significant terms of contracts to issue additional shares. The standard also requires disclosure, within the financial statements, of the number of shares that would be issued upon conversion, exercise, or satisfaction of required conditions during at least the most recent annual fiscal period and any subsequent interim period presented.

This Statement is effective for financial statements for periods ending after December 15, 1997. It contains no change in disclosure requirements for entities previously subject to the requirements of APB Opinions 10, *Omnibus Opinion—1966*, and 15, *Earnings per Share*, and FASB Statement No. 47, *Disclosure of Long-Term Obligations.*

FASB Statement No. 130, *Reporting Comprehensive Income*[8]

The issuance of Statement No. 130 will affect all clients with foreign-currency transactions, minimum pension liability adjustments, and unrealized gains and losses on investments in debt and equity securities. Under current accounting standards, these components of *other comprehensive income*[9] are not included in determining net income but are accumulated and reported separately as a component of equity.

The new requirement is for all components of *comprehensive income*, including both those recognized as part of net income and those excluded from net income, to be reported in a financial statement that is displayed with the same prominence as other financial statements. A specific format for that financial statement is not required, but the entity must—

- Classify items of *other comprehensive income* by their nature in the financial statement.
- Display an amount representing *total comprehensive income* for the period in the financial statement.
- Display the accumulated balance of *other comprehensive income* separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position.

The Statement includes several examples of acceptable formats.

This Statement is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required.

8. The term *comprehensive income* is defined in FASB Concepts Statement No. 6, *Elements of Financial Statements* (FASB, *Original Pronouncements*, vol. 2, sec. CON6), as "the change in equity [net assets] of a business enterprise during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners."

9. FASB Statement No. 130 uses the term *comprehensive income* to describe the total of all components of comprehensive income, including net income. The term *other comprehensive income* refers to revenues, expenses, gains, and losses that under GAAP are included in comprehensive income but excluded from net income.

Other Recent GAAP Pronouncements

FASB Statement No. 127, *Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125 an amendment of FASB Statement No. 125* (FASB, *Current Text*, vol. 1, sec. F38), defers for one year the effective date of some of the provisions of Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FASB, *Current Text*, vol. 1, sec. F38). This Statement provides additional guidance on the types of transactions for which the effective date of Statement No. 125 has been deferred. All provisions of Statement 125 should continue to be applied prospectively, and earlier or retroactive application is not permitted.

FASB Statement No. 128, *Earnings per Share* (FASB, *Current Text*, vol. 1, sec. E11), establishes standards for computing and presenting earnings per share (EPS) and applies to entities with publicly held common stock or potential common stock. This Statement simplifies the standards for computing earnings per share previously found in APB Opinion 15, *Earnings per Share*, and makes them comparable to international EPS standards. This Statement does not apply to nonpublic business enterprises or to not-for-profit organizations.

Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. This Statement does not apply to nonpublic business enterprises or to not-for-profit organizations.

Proper Accounting for Distributions to Owners

Are there any rules on accounting for distributions to owners?

Practice is diverse regarding the accrual of distributions to owners of S corporation and partnership interests. As tax-planning vehicles, many S corporations and partnerships make, at year end, distributions of cash to their equity owners in the amount of the anticipated income tax liability that will accrue to the owners as a result of their ownership of the shares or partnership interests. Often these amounts are accrued in the interim financial statements of the corporation or partnership throughout the year in an attempt to match the tax expense to the revenue of the entity.

It is important to realize that these income tax accruals are not an expense of the S corporation or partnership, but rather a distribution of earnings. Furthermore, unless the board of directors declares dividends, the accruals are not a liability of the entity. The transaction or event that obligates the entity to pay a dividend is the declaration of the dividend by the board of directors. Until that event has occurred, the entity is not obligated and has the ability to avoid the future sacrifice.

The proper treatment of a distribution to an equity owner in a partnership or S corporation would be to record a debit to retained earnings and a credit to a liability at the date of the declaration by the board of directors.

The Internet — An Accountant's Research Tool

If used appropriately, the Internet can be a valuable tool for accountants doing compilation and review work. Through the Internet, accountants can access a variety of global business information, such as Securities and Exchange Commission (SEC) filings, professional news, state CPA society information, Internal Revenue Service information, software downloads, university research materials, currency exchange rates, stock prices, annual reports, and legislative and regulatory initiatives. Not only are such materials accessible from the computer, but they are also available at any time, free of charge.

There are some caveats to keep in mind when using the Internet. Reliability varies considerably. Some information on the Internet has not been reviewed or checked for accuracy; therefore, caution is advised when accessing data from unknown or questionable sources. Although a vast amount of information is available on the Internet, much of it is of little or no value to accountants. Accordingly, accountants should learn to use search engines effectively to minimize the amount of time browsing through useless information. The Internet is best used in tandem with other research tools, believe it is unlikely that sufficient research can be conducted solely from Internet sources.

Some Web sites that may provide valuable information to accountants include the following:

Name of Site	*Content*	*Internet Address*
American Institute of CPAs	Summaries of recent developments at the ARSC and other professional standards-setting committees and other AICPA activities	http://www.aicpa.org
FASB	Summaries of recent accounting pronouncements and other FASB activities	http://www.fasb.org
Governmental Accounting Standards Board	Summaries of recent accounting pronouncements and other GASB activities	http://www.gasb.org
CPAs *Weekly News Update*	An electronic newsletter with topics of interest to accountants and auditors	http://www.hbpp.com/weekup/weekup.html
CPAnet	Links to other Web sites of interest to CPAs	http://www.cpalinks.com
Accountant's Home Page	Resources for accountants and financial and business professionals	http://www.computercpa.com
Double Entries	A weekly newsletter on accounting and auditing around the world	http://www.csu.edu/lists.anet/ADBLE-L/index.html
Internet Bulletin for CPAs	CPA tool for Internet sites, discussion groups, and other resources for CPAs	http://www.kentis.com/ib/html

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Technical Hotline

The AICPA Technical Hotline answers members' inquiries about accounting, auditing, attestation, compilation, and review services. Call: (800) 862-4272 (menu selection #2).

Ethics Hotline

Members of the AICPA's Professional Ethics Division answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. Call: (800) 862-4272 (menu selection #4).

AICPA World Wide Web Page

The AICPA World Wide Web pages at http://www.aicpa.org, contains information about proposed standards and recent publications. It is also the location of the Accountants' Forum, where members of the profession discuss professional and technical issues.

APPENDIX

Conforming Changes to SSARS No. 1 Reflecting the Issuance of SAS Nos. 78 and 82

In February 1997, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316). The new standard supersedes SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (AICPA *Professional Standards*, vol. 1, AU sec. 316), and provides auditors with expanded guidance on the consideration of fraud in a financial statement audit. One of the changes introduced by SAS No. 82 is the substitution of the word fraud for the word *irregularities.* Here are marked sections of Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements*, showing conforming changes that were made to SSARS No. 1 to reflect the issuance of SAS Nos. 78 and 82. Added text is underlined. Deleted text is struck out.

Conforming Changes in SSARS No. 1, Paragraph 8

Understanding With the Entity

.08 The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report the accountant expects to render. The understanding should also provide (*a*) that the engagement cannot be relied upon to disclose errors, ~~irregularities~~ *fraud*, or illegal acts and (*b*) that the accountant will inform the appropriate level of management[9] of any material errors that come to his or her attention and any ~~irregularities~~ *fraud* or illegal acts that come to his or her attention, unless they are clearly inconsequential. Examples of engagement letters are presented in Appendixes B and C. [As amended by Statement on Standards for Accounting and Review Services 7, effective for periods ending after December 15, 1993. Reports issued or reissued after December 15, 1993, should conform with the reporting guidance in SSARS 7.]

[9] When ~~an irregularity~~ *a fraud* or illegal act involves senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the owner/manager or the board of directors. [Footnote added by the issuance of Statement on Standards for Accounting and Review Services 7, November 1992.]

Conforming Changes in SSARS No. 1, Appendix B

Compilation of Financial Statements — Illustrative Engagement Letter

2. We will also... (discussion of other services).

Our engagement cannot be relied upon to disclose errors, ~~irregularities~~ *fraud,* or illegal acts, ~~including fraud or defalcations~~, that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any ~~irregularities~~ *fraud* or illegal acts that come to our attention, unless they are clearly inconsequential.

Our fees for these services...

Conforming Changes in SSARS No. 1, Appendix C

Review of Financial Statements — Illustrative Engagement Letter

1. We will review the balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Our review will consist primarily of inquiries of company personnel and analytical procedures applied to financial data and we will require a representation letter from management. A review does not contemplate obtaining an understanding of internal control ~~structure~~ or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that we will become

aware of all significant matters that would be disclosed in an audit. Our engagement cannot be relied upon to disclose errors, ~~irregularities~~ *fraud*, or illegal acts, ~~including fraud or defalcations~~, that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any ~~irregularities~~ *fraud* or illegal acts that come to our attention, unless clearly inconsequential....